TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 06-40

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Sales and use tax registration and reporting requirements for affiliated entities.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

"Parent" manufactures, sells, and leases to its ultimate customers equipment and supplies that are necessary to operate that equipment. Parent also provides maintenance services for the equipment that it has sold or leased to its customers.

Parent conducts its leasing activities through its "Subsidiary," a wholly-owned single member LLC. Both Parent and Subsidiary occupy the same physical location.

Due to the competitive pricing within the industry, it is the common practice to bundle, as a single charge, the lease payment, the fee for maintenance, and the charge for supplies. Parent and its customers desire a composite invoice for the above-mentioned charges.

When Parent's customers lease (rather than purchase) the equipment, Subsidiary is involved in the following two steps:

1. Parent sells the equipment to Subsidiary under a sales and service agreement.
2. Then, Parent and Subsidiary enter into a leasing contract with the customer.

The terms of the two contracts mentioned above result in:

1. Parent invoices the customer for the lease payments.
2. Parent collects lease payments from the customer.
3. Parent forwards the lease payments to Subsidiary.
4. Customer is responsible for paying (to Parent) any sales or use tax due on the leased equipment.
5. Customer makes its lease payments, with applicable sales tax, to Parent.

Customers who lease the equipment from Subsidiary rather than purchase the equipment from Parent usually purchase the related supplies and maintenance services from Parent. Parent performs all invoice processing for both its own sales transactions and Subsidiary's lease transactions. Parent sends the customer a single invoice that includes all charges for lease payments, supplies furnished, and maintenance services in a single bundled amount, plus applicable sales tax.

Parent is registered with the Department and collects tax on sales to its Tennessee customers. Currently, the Subsidiary does not lease any property within Tennessee. Subsidiary anticipates providing Parent with a resale certificate and leasing the equipment to its customers in Tennessee.

QUESTIONS

1. May Parent submit sales and use tax returns under Parent's account as an "agent filer" for Subsidiary?

2. If such a filing is permitted, is Subsidiary required to register with the Department and file returns?

3. If either Parent or Subsidiary should be audited by the Department, will both be audited and any overpayment or underpayment offset between the two companies?

RULINGS

1. Parent may pay the tax owed by Subsidiary on its own return, if such an arrangement is requested at the time of registration.

2. In conjunction with the registration of Parent, the Department will create an account for Subsidiary. Subsidiary will not be required to file its own returns.

3. The Department declines to issue a ruling on this question.

ANALYSIS

Tenn. Code Ann. § 48-249-1003, enacted by the General Assembly in 2005, makes the following provisions concerning the classification of a limited liability company for Tennessee tax purposes:

> For purposes of all state and local Tennessee taxes, a domestic or foreign LLC shall be treated as a partnership or an association taxable as a corporation, as such classification is determined for federal income tax purposes. The members, and any other equity owners of a foreign LLC treated as a partnership, are subject to all state and local Tennessee taxes in the same manner and extent as partners in a foreign partnership. The members and holders of financial rights of a domestic LLC are subject to all state and local Tennessee taxes in the same manner and extent as partners in a domestic partnership.

The Tennessee Revised Limited Liability Company Act was passed in 2005 and took effect on January 1, 2006. The foregoing language is nearly identical to the original language promulgated in 1994 in the Tennessee Limited Liability Company Act at Tenn. Code Ann. § 48-211-101. The apparent legislative intent of Tenn. Code Ann. § 48-211-101 was to classify limited liability companies for Tennessee state and local tax purposes in the same manner that they are classified for federal income tax purposes. Tenn. Code Ann. § 48-211-101, however, was enacted in 1994 prior to the adoption of Treas. Reg. § 301.7701-3,[1] better known as the "check-the-box" provisions. The check-the-box provisions created standards under which a single member limited liability company would be disregarded as an entity separate from its owner. Neither the original language of Tenn. Code Ann. § 48-211-101 nor the language of Tenn. Code Ann. § 48-249-1003 specifically address federal income tax classification elections by eligible limited liability companies under the check-the-box provisions or an election by a limited liability company to be disregarded as an entity separate from its owner. The new Tenn. Code Ann. § 48-249-1003 simply repeats the substantive language from Tenn. Code Ann. § 48-211-101 and does not update the language for the check-the-box provisions. The failure of Tenn. Code Ann. § 48-249-1003 to update the language does not negate the legislature's original intent to classify a limited liability company for state and local purposes in the same manner as its federal classification, unless specifically otherwise provided.

If a single member limited liability company has made a valid election to be disregarded as an entity separate from its owner under Treas. Reg. § 301.7701-3 or is so classified by the default provisions, it will be disregarded as an entity separate from its owner for Tennessee state and local tax purposes, unless an applicable statute requires otherwise.[2]

Based on the foregoing, the Department will treat Subsidiary as a disregarded entity for sales and use tax purposes. Subsidiary will be treated as a division of Parent, and intercompany transactions, including intercompany sales, will be disregarded. The

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[1] Treas. Reg. § 301.7701-3 (1997).

[2] *See, e.g.*, Tenn. Code Ann. §§ 67-4-2006(a)(6); 67-4-2007(d); and 67-4-2106(c).

Department will require registration by Parent and permit all sales and use tax liability for both Parent and Subsidiary to be reported on a single return. In conjunction with the registration of Parent, the Department may obtain necessary information regarding Subsidiary and create a registration for Subsidiary. However, the account for Subsidiary will be coded by the Department such that no returns will be required to be filed, and the Department's records will show sales and use tax is to be remitted by Parent. The existence of Subsidiary and its relationship to Parent should be disclosed to the Department at the time of registration.

With respect to the third question, decisions on which taxpayer may or may not be audited or how an audit will be conducted are not generally addressed in a ruling of this type. The Department, therefore, declines to issue a ruling on this issue.

Deborah A. Toon
Tax Counsel

APPROVED: Loren L. Chumley

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